



# Commonwealth of Massachusetts State Ethics Commission

One Ashburton Place, Room 619, Boston, MA, 02108  
phone: 617-727-0060, fax: 617-723-5851



## **CONFLICT OF INTEREST OPINION EC-COI-91-12**

The Company is a non-profit, tax exempt holding company which was created subsequent to a resolution passed by the trustees of a state institution. The Company is comprised of four subsidiary non-profit entities. The Company derives most of its income from its programs, from its start-up loans and from fundraising. At present, around three-fourths of the Company's indebtedness consists of commercial bank loans and around one fourth is from state institution loans. The current Board of Directors has nine voting embers and two, ex-officio non-voting members. Three of the nine voting directors and one of the two ex-officio members are individuals associated with the state institution.

The Commission has twice determined, prior to this opinion request, that the Company is a state instrumentality, subject to the conflict of interest law, G.L. c. 268A. See, EC-COI-84-147; 89-1. In EC-COI-84-147, the Commission based its jurisdictional conclusion on facts that: (1) the Company was created pursuant to a resolution passed by the trustees of the state institution; (2) the Company performed a governmental function in searching means to raise revenues for the state institution to comply with that entity's legislative mandate to finance, manage and protect the economic viability of the institution; and (3) the Company was subject to substantial state control because the selection process and the composition of its board was dominated by directors with government (state) affiliations.

The sequel opinion, EC-COI-89-1, presented similar facts in addition to certain proposed changes to the Company's organizational structure. In particular, the proposed changes related to the voting requirements of certain board actions and a requirement that a minimum of one-third but less than one half of the Company's voting directors be individuals affiliated with the state institution. In evaluating the facts of 89-1, the Commission found the stimulus for the creation of the Company and its mandate to raise funds remained governmental in nature - similar to the conclusions found in 84-147. And, inasmuch as the proposed Company's organizational changes still resulted in substantial control by state-affiliated directors, the sum of these factors rendered the Company a public entity for the purposes of c. 268A.

The Company presently requests this opinion on changed facts. The Company has amended its by-laws regarding a provision pertaining to the number and qualifications of the Board of Directors.<sup>1/</sup> [Text of the amended version with footnote deleted]

Of significance to this opinion is the fact that the new by-law changes the size of the Board of Directors and alters the requirement that a minimum number of voting directors be state institution-affiliated individuals. In the new by-law, one third or less of the voting directors may be state-affiliated.

### **QUESTION:**

Whether, in view of the above organizational changes to its by-laws, would the Company continue to be a state agency for the purposes of the conflict of interest law, G.L. c. 268A?

**ANSWER:**

No.

**DISCUSSION:**

Prior to this opinion, the Ethics Commission concluded on two occasions that the Company was a "state agency" under the conflict of interest law, G.L. c. 268A, s.1(p).<sup>2/</sup> See, EC-COI-84-147; 89-1. In those opinions, the jurisdictional status of the Company was evaluated in light of criteria drawn from established Commission precedent.

The Commission has consistently stated that the application of the conflict law cannot be conditioned solely on an entity's organizational status. EC-COI-88-19 (organization's corporate structure is not sufficient to exempt it from definition of a municipal agency); EC-COI-88-24; In the Matter of Louis L. Logan, 1981 SEC 40, 45. See also, EC-COI-84-147 (the Company's non-profit corporate structure did not exempt it from being a state entity under the conflict law).

Therefore, the Company must be examined under the four factors the Commission has developed to determine whether an organization is a public entity under c. 268A. These factors are:

- (1) the means by which the entity was created (e.g., legislative or administrative action);
- (2) the entity's performance of some essentially governmental function;
- (3) whether the entity receives and/or expends public funds; and
- (4) the extent of control and supervision exercised by government officials or agencies over the entity. See, EC-COI-88-2; 85-22; 84-65.

The Commission recently applied these four factors in two opinions. In EC-COI-90-3, the Commission found a non-profit foundation organized to support a state college was a state entity for the purposes of c. 268A. The Commission determined that the foundation was: (i) created to further the legislative purpose of a state college; (ii) performing a governmental function in raising revenues to support a state institution; (iii) using state resources and funds for its operation; and (iv) subject to potential and actual control by state affiliated board members.

In EC-COI-90-7, the Commission reviewed the status of a state agency's retirement fund board. The Commission concluded that the board was: (i) a governmentally created entity springing from the trust agreement between a state agency and a union under the broad legislative authority accorded to that state agency; (ii) created to conduct a public function - the administration of pensions for state employees; (iii) significantly funded from or on behalf of a state agency; and (iv) governed by a board of directors composed of a plurality of officials from the state agency and who were accountable to that state agency.

Presently, we reconsider the Company's status under c. 268A in view of recent changes made to its bylaws. In our view, the impetus for the creation of the nonprofit holding company remains governmental in nature inasmuch as the creation of the corporation, as described in 84-147 and 89-1, came about because of the resolution passed by the board of trustees of the state institution. See, EC-COI-88-24; 89-24. We would note, however, that with the passage of

time, and compositional changes in the corporation, the so called "impetus" factor diminishes in significance.

With respect to the second factor, while the function of the holding company has been clarified by the April 5, 1989 resolution passed by its Board of Directors, it does not alter our conclusions drawn in 89-1. The resolution states that the Company is a separate entity operating solely as a non-profit corporation and not under the umbrella of the state institution. The resolution does not change the nature of the holding company's corporate purpose (to promote the purposes of the state institution), nor change the statutory language which gives the state institution's board of trustees responsibility for protecting the financial viability of the state institution.

The Company's financing is derived from both private and public funds. While start-up funds for the Company originally came from the state institution, current Company financing is largely derived from commercial bank loans which do not involve the state institution. Based upon this fact, we conclude that the third Commission factor (whether the entity receives and/or expends public funds) would be met minimally, if at all.

While the four Commission jurisdiction factors are relevant, the pivotal question presented in this reconsideration is whether state-affiliated institution members will retain control over the Company's operations under the current corporate by-laws. We conclude that the present organizational changes to the Company's by-laws significantly alter the nature and extent of governmental control exercisable over that entity. These changes lead us to a different result under the fourth jurisdictional factor inasmuch as governmentally affiliated board members are not now assured a position of control over the Company's actions.

Our conclusion is based on the fact that the board of directors may now be made up of a minimum of eight and a maximum of eleven voting members. Of those voting directors, state-affiliated directors<sup>3/</sup> may comprise one-third or less of the total number of voting directors. This by-law provision significantly impacts both the corporate organizational structure and its functional operation. First, there is no requirement that a minimum number of state-affiliated individuals serve as directors. Second, the ceiling placed on the number of state-affiliated voting directors is one-third or less of the total number of voting directors. State-affiliated voting directors thus would have reduced control, both actual and potential, over board decisions. The current by-law reduces the possibility of state employees' voting as a significant block to the Board's action and in their potential domination of a quorum of any particular board meeting.

We conclude the current Company's by-law effectuates more than mere compositional changes in the board of directors. EC-COI-84- 64; 88-19. The potential for control of the Company by state employees is nearly eliminated since all board actions must be made by a majority of voting directors constituting a valid quorum. See, EC-COI-90-3.

In weighing all the factors as applied to the Company, above, we conclude given the lack of public funding currently available to the Company, and the lack of public control, the Company is now properly deemed to be a private, non-public entity falling outside of the jurisdiction of c. 268A.<sup>4/</sup>

**DATE AUTHORIZED:** September 11, 1991

---

<sup>1</sup> The Amendment was adopted by the Board of Directors on March 22, 1991.

<sup>2</sup> "State agency," any department of a state government including the executive, legislative or judicial, and all councils thereof and thereunder, and any division, board, bureau, commission, institution, tribunal or other instrumentality within such department and any independent state authority, district, commission, instrumentality or agency, but not an agency of a county, city or town. G.L. c. 268A, s.1(p).

<sup>3</sup> "State affiliated" directors as defined in Footnote 2 above.

<sup>4</sup> The possibility exists that a Company Board consisting of nine voting members could have three state affiliated voting directors, all of whom are counted as part of a five-member quorum. The three state-affiliated directors would then comprise more than one-half of that particular quorum. We conclude that this potential scenario does not reach the threshold of continuing or substantial governmental control or supervision exercised by the public employees as evidenced in opinions EC-COI-90-3 and 90-7. The type of governmental control over the Company in this instance must be more than a fortuitous circumstance. If, however, the Commission were to review facts or circumstances pointing to a continued pattern of domination or control by state affiliated directors, this jurisdictional conclusion may not apply.